

2018-19 AUDIT PLAN

California Department of Transportation
Independent Office of Audits & Investigations



**Report of the Inspector General
July, 2018**

TABLE OF CONTENTS

EXECUTIVE SUMMARY	2
PURPOSE AND SCOPE OF THE PLAN	3
ORGANIZATIONAL STRUCTURE	4
ACCOUNTABILITY UNDER SB 1	4
DIVERSITY AND SMALL BUSINESS DEVELOPMENT	6
CALTRANS OPERATIONS	7
DIVISION OF RAIL AND MASS TRANSPORTATION	8
ARCHITECTURAL & ENGINEERING CONTRACTS	8
CONSTRUCTION CONTRACTS	9
STEWARDSHIP AND OVERSIGHT OF FEDERAL FUNDS	10
MANDATED AUDITS AND ASSIGNMENTS	11
INVESTIGATIONS AND ETHICS HELPLINE	13

EXECUTIVE SUMMARY

The Road Repair and Accountability Act, Chapter 5, Statutes of 2017 (SB 1), created the Independent Office of Audits and Investigations (IOAI) to ensure the California Department of Transportation (Caltrans) and external entities that receive state and federal transportation funds from Caltrans are spending those funds efficiently, effectively, economically, and in compliance with applicable state and federal requirements.

SB 1 requires the Governor to appoint an Inspector General to lead the IOAI for a six-year term. The Inspector General has a duty to review policies, practices, and procedures and conduct audits and investigations of activities involving transportation funds administered by the department. The Inspector General is required to report a summary of investigation and audit findings and recommendations at least annually to the Governor, the Legislature, and the California Transportation Commission.

Pursuant to SB 1, the IOAI provides a full scope, independent, and objective audit and investigation program. The 2018-19 Audit Plan is a guiding document that outlines audit and investigative priorities and identifies specific engagements to be performed during the coming year.

Key audits detailed in this plan include:

- Efficiency measures to achieve \$100 million in savings.
- Progress toward SB 1 performance outcomes.
- Accountability for local assistance programs.
- Increasing procurement opportunities for new and limited contracting small business enterprises.

The Audit Plan also includes audits and reviews of financial documents of architectural and engineering firms that contract with Caltrans and local entities. In accordance with Caltrans' role to provide stewardship and oversight of federal funds, local government Indirect Cost Rate proposals, Indirect Cost Allocation Plans, and Incurred Costs will be reviewed and audited as appropriate.

Investigations of ethics policy violations, conflicts of interest, incompatible activities, criminal activities, fraudulent or corrupt practices, misuse of state resources, and other employee misconduct are conducted when alleged. Information about conducting investigations and managing Caltrans' Ethics Helpline is included in the Audit Plan.

PURPOSE AND SCOPE OF THE PLAN

The 2018-19 Audit Plan identifies assignments and sets direction for the Independent Office of Audits and Investigations (IOAI) for the period July 1, 2018, through June 30, 2019. The Audit Plan is a guiding document that is subject to change based on the availability of resources and the need to set new priorities or initiate different projects over the course of the year.

The Audit Plan proposes audits, investigations, and reviews that are 1) mandated by state or federal law or policy, 2) determined necessary to comply with state or federal reporting requirements, and/or 3) selected after an assessment of the risk factors or conditions that, absent effective management, could adversely affect the ability of Caltrans and external entities to accomplish stated goals and priorities. In addition, the Audit Plan includes consulting engagements identified to improve Caltrans operations and/or processes.

As part of the assessment of risk within Caltrans, IOAI staff considered the following risk factors: asset management; effective coordination of SB 1 programs; ability to recruit, hire, train, and retain well-qualified staff; shift to multi-modal transportation planning and policy; need to modernize technology systems; and ability to achieve performance targets. The financial impact of these factors, specific directives in law, recent or past audit experience, and employee disciplinary information were also considered.

The selection of audits and reviews of external entities is also risk-based. Risk was assessed using a number of factors including, but not limited to: little or poor prior audit history, past whistleblower or ethics complaints received, and financial impact. Much of the external audit work is mandated by law or policy, requested by Caltrans, and/or by agreement with the Federal Highway Administration.

The California Legislature designated the California State Auditor (CSA) as the responsible agency to perform the annual audit of the state's financial statements and compliance with the Single Audit Act. This Audit Plan does not provide for an independent audit of the Caltrans financial management system; however, CSA may rely on certain audits performed by the IOAI when performing the Single Audit. Caltrans, as a pass-through entity of federal funds, must ensure local government agencies, universities, and non-profit entities comply with single audit requirements. The IOAI assists the department in this effort.

ORGANIZATIONAL STRUCTURE

SB 1 requires the Governor to appoint an Inspector General to lead the Independent Office of Audits and Investigations (IOAI) and upon confirmation of the California State Senate, the Inspector General shall serve a six-year term. The Inspector General is vested with the authority to exercise all responsibility for maintaining a full scope, independent, and objective audit and investigation program as prescribed by law. The Inspector General has a duty to review policies, practices, and procedures and conduct audits and investigations of activities involving state transportation funds administered by the department.

The Inspector General is required to report findings and recommendations to the Secretary of Transportation and the director and chief deputy director of Caltrans on an ongoing and current basis. At least annually, or upon request, the Inspector General is required to report to the Governor, the Legislature, and the California Transportation Commission (CTC) with a summary of investigation and audit findings and recommendations.

ACCOUNTABILITY UNDER SB 1

Efficiency measures to achieve \$100 million in savings.

SB 1 requires Caltrans to implement efficiency measures with the goal to achieve at least \$100 million in savings to invest in maintenance and rehabilitation of the state highway system. Caltrans is required to report the savings to the California Transportation Commission (CTC). An interim report that identified the expected savings in specific program areas was submitted to the CTC in January 2018.

As proposed in last year's 2017-18 Audit Plan, staff began an audit to determine if Caltrans has internal controls in place to ensure the program areas identified can achieve the estimated savings. The draft audit report is expected in July 2018. The audit objectives include:

- The methods of calculating efficiency savings are appropriate and supported.
- Caltrans has adopted a definition for efficiency savings and cost avoidance.
- There is an oversight body responsible for establishing a structure of authority, providing guidance, and monitoring the accuracy and reliability of the efficiency savings reported.
- There are policies, procedures, and guidelines in place to assist programs, districts, and divisions in identifying, measuring, and reporting efficiency savings.

In 2018-19, an audit with similar objectives will be initiated for efficiencies not previously reviewed. Additionally, after Caltrans submits its annual report to the CTC in October 2018, the IOAI will develop a follow-up audit, as necessary, to determine whether the \$100 million savings reported by Caltrans is supported and available for reinvestment in the maintenance and rehabilitation of the state highway system.

Progress toward achieving SB 1 performance outcomes.

SB 1 establishes performance outcomes for five state highway assets:

- Not less than 98 percent of pavement in good or fair condition.
- Not less than 90 percent level of service achieved for maintenance of potholes, spalls, and cracks.
- Not less than 90 percent of culverts in good or fair condition.
- Fix at least an additional 500 bridges.
- Not less than 90 percent of transportation management system (TMS) units in good condition.

In April 2018, the IOAI completed an audit to determine if Caltrans had established an appropriate baseline to measure future progress toward achieving the performance goals. The audit determined that Caltrans has made progress with the maintenance and bridge assets, but policies and procedures were needed to measure “level of service.” The audit recommended comprehensive inventories of culverts and transportation management system elements be completed. The audit did not address the pavement asset class because Caltrans finalized its first Transportation Asset Management Plan (TAMP) and related benchmarks after fieldwork was completed.

The 2018-19 Audit Plan includes two audits to determine if Caltrans has established a methodology and policies and procedures for the selection of pavement and TMS projects that will support progress toward SB 1 performance outcomes.

Increasing accountability for local assistance programs.

SB 1 states the intent of the Legislature to hold Caltrans and local governments accountable for the efficient investment of transportation funds including through performance goals that are tracked and reported. The California Transportation Commission (CTC) adopted SB 1 Accountability and Transparency Guidelines that apply to all specified SB 1 programs. Additionally, individual program guidelines, such as Active Transportation Program Guidelines and Local Partnership Program Guidelines, were adopted and define specific program-level requirements.

Pursuant to CTC guidelines, Caltrans provides the administrative oversight for SB 1 programs and ensures the terms and conditions of the CTC guidelines and subsequent programming, allocation, reporting, and other actions are followed. The 2018-19 Audit Plan includes a

consulting engagement with Caltrans' Division of Local Assistance to provide recommendations for effectively implementing the actions required by the CTC guidelines.

The Audit Plan also includes audits of local recipients that received funding under the Active Transportation Program (ATP). The objective of these audits is to determine if project costs claimed and reimbursed are supported and in compliance with agreement provisions and state and federal laws and regulations, and will determine if expected performance outcomes and outputs are achieved. Additionally, audits will be performed to determine if the local entities have a financial management system capable of accumulating and segregating costs that are reasonable, allowable, and can be allocated to projects or specific cost objectives.

The local ATP audits and the consulting engagement with Caltrans will be undertaken simultaneously in an effort to share information learned from work with the local entities with Caltrans so its Division of Local Assistance can adapt and improve policies and processes to ensure better adherence to the CTC guidelines.

Effectiveness of Caltrans' Enterprise Risk Management Program.

SB 1 directs the Independent Office of Audits and Investigations (IOAI) to ensure Caltrans is administering an effective enterprise risk management program. In addition, the International Standards for the Professional Practice of Internal Auditing require an audit plan based on a documented risk assessment, undertaken at least annually. Finally, Caltrans' Enterprise Risk Management (ERM) unit is responsible for the biennial State Leadership Accountability Act enterprise risk assessment as well as smaller risk assessments identified within the department. The 2018-19 Audit Plan includes an audit to 1) assess the effectiveness of the Caltrans risk management plan and 2) determine whether the IOAI can rely on the work of ERM and other internal and external sources to properly assess risk during the development of the annual audit plan.

DIVERSITY AND SMALL BUSINESS DEVELOPMENT

Increasing procurement opportunities for new and limited contracting small business enterprises.

Chapter 5, Statutes of 2017 (SB 103), requires Caltrans to submit a report to the Legislature by January 1, 2019, detailing an outreach plan to increase procurement opportunities for new and limited contracting small business enterprises, including, but not limited to, those owned by women, minorities, disabled veterans, LGBT individuals, and other disadvantaged groups. SB 103 directs the Inspector General to review, audit, and report on Caltrans' outreach efforts. The 2018-19 Audit Plan includes an audit to assess Caltrans' outreach plan, including: methods for sharing procurement and training opportunities, review of targeted audience, feedback and process improvement surveys, and identification of events and partners.

Ensuring valid identification of small, disadvantaged, disabled veteran, and LGBT businesses.

SB 103 requires the Inspector General to audit businesses, as appropriate, to determine that persons or entities do not circumvent the goal of SB 1 and SB 103 to create new contracting opportunities for the identified groups. Prior to selecting audits of businesses, this plan includes a review of the processes used to identify small businesses, disadvantaged, disabled veteran, and LGBT businesses. The results of this review may provide insight into the strengths and weaknesses of this process and guide selection of audits based on the highest risk areas.

Incorporating review of equitable practices in all applicable audits.

In SB 103, the Legislature expressed concerns that complex contracting laws and practices in the state, insufficient outreach and technical assistance provided by state agencies, and other barriers result in reduced levels of participation of women and minorities in California's labor force. Whenever feasible, questions of equal opportunity will be considered as part of the scope and objective of an audit or review. For example, the 2018-19 Audit plan includes review of an effort to streamline hiring processes in the Caltrans Maintenance Division and audits of local procurement practices. In both cases, the scope of work will include questions that assist in making recommendations consistent with the intent of SB 103 to increase procurement opportunities and prevent discrimination.

In addition, the Deputy Inspector General for Diversity and Small Business Development will release a report in 2018 presenting observations of current practices and identifying key operational risk areas for consideration by Caltrans management.

CALTRANS OPERATIONS

Addressing information technology risks.

In its December 2017 State Leadership Accountability Act report to the Department of Finance (DOF), Caltrans identified the need to modernize technology systems that do not currently meet business needs. Caltrans received additional funding in the 2018-19 Budget Act to develop an Information Technology Roadmap that—once approved by DOF and the California Department of Technology—will guide replacement of technology that is at the end of its useful life.

The 2018-19 Audit plan includes an audit to determine whether Caltrans is in compliance with State Administrative Manual (SAM) and Statewide Information Management Manual (SIMM) requirements to establish and maintain appropriate computer software management practices and ensure that computer software used and/or purchased with state funds is legally procured and is used in compliance with licenses, contract terms, and applicable copyright laws.

A second audit will document and evaluate Caltrans' information technology governance process and incorporate findings into the ongoing risk assessment process. These two audits will assist the department as it moves forward to address information technology risks.

Evaluating efforts to streamline Maintenance hiring process.

At the request of Division of Maintenance, the 2018-19 Audit Plan includes an evaluation of the effectiveness of a new streamlined hiring process for field maintenance personnel.

Ensuring accurate headquarters designation on travel expense claims.

At the request of Division of Accounting, the 2018-19 Audit Plan includes an audit of Travel Expense Claims (TEC) to determine the accuracy of headquarters designation. This audit began in the previous fiscal year.

DIVISION OF RAIL AND MASS TRANSPORTATION

Improving procurement and contract management for the Division of Rail and Mass Transportation.

The Division of Rail and Mass Transportation (DRMT) is responsible for contract management of its agreements with Joint Power Authorities, local agencies, and non-profit organizations. The 2018-19 Audit Plan includes two audits of this program. The first, initiated in the prior fiscal year, will determine if the delegated authority exists for DRMT to execute contracts and agreements and evaluate if internal controls over procurement functions are adequate. The second audit, proposed for 2018-19, will determine if contract management roles and responsibilities are being fulfilled and the state is receiving the benefits identified in the contracts.

ARCHITECTURAL & ENGINEERING CONTRACTS

Reviewing Architectural & Engineering consultant bid proposal documents.

As a service to the Caltrans Division of Procurement and Contracts (DPAC), the Independent Office of Audits and Investigations (IOAI) reviews financial documents from Architectural and Engineering (A&E) firms submitted to Caltrans as part of a bid proposal. In addition, the IOAI performs audits of the Indirect Cost Rates of A&E consultants contracting with Caltrans. The selection of documents for review is based on risk factors that include total consultant participation amount, results of previous reviews, and risks identified by DPAC. The 2018-19 Audit Plan continues this service, as detailed below, and expands similar reviews and audits of A&E bid proposals submitted to local agencies as required of all state transportation agencies by the Federal Highway Administration (FHWA).

Reviewing financial documents prior to contract execution.

The IOAI performs a high-level review of consultant financial documents submitted to DPAC and local agencies to determine if the Indirect Cost Rate and direct costs in a bid proposal are supported, reasonable, and in compliance with the cost principles set forth by FHWA in 48 CFR Part 31 and 23 CFR Part 172. Recommendations are made to DPAC and local agencies to adjust costs as needed prior to contract execution.

Reviewing Indirect Cost Rate Audits performed by Certified Public Accountants (CPAs) of A&E consultants.

The IOAI reviews the Indirect Cost Rate Audits performed by CPAs of A&E consultants with contracts of \$3.5 million and greater to ensure the audit was performed under Government Auditing Standards and the proposed rates are in compliance with the cost principles set forth by FHWA in 48 CFR Part 31.

Completing independent audits of A&E consultants Indirect Cost Rates.

The IOAI performs audits of the Indirect Cost Rates of A&E consultants contracting with Caltrans. Audits are performed under Government Auditing Standards to ensure the proposed rates are in compliance with the cost principles set forth by FHWA in 48 CFR Part 31.

Audits of local governments A&E contract procurements.

In addition to reviewing A&E firms bid proposal documents, the 2018-19 Audit Plan includes audits of local governments' procurements to ensure they are complying with applicable state and federal procurement requirements. The objective of these audits is to determine whether contracts are procured with fair and open competition and at fair and reasonable cost.

CONSTRUCTION CONTRACTS

Audits of Extra Work-at-Force/Change Order Accounts on highway construction.

The 2018-19 Audit Plan includes audits of payments to construction contractors for "Extra Work-at-Force Account" change orders that allow for payment for time and material work (labor, materials, equipment, and markup) added to the original scope of a contract. This method of payment is only allowed when strictly necessary such as when the extent of work is unknown or is of such character that a price cannot be determined to a reasonable degree of accuracy. Audits are performed to determine if billed costs are in compliance with Caltrans Standard Specifications, consistent with contract provisions, and the contractor's financial management system is adequate to accumulate and segregate allowable project costs. Contracts selected for audit are based on funding type, funding amount, number of previous construction contracts, input from Division of Construction, issues with Division of Labor Compliance, and past audit results.

Special requests.

At the request of the Caltrans Division of Capital Outlay Support, audits are conducted of construction contractors' claims of financial damages resulting from projects delayed and/or terminated by Caltrans. Audits are performed to determine if claimed costs are allowable, allocable, reasonable, and in compliance with federal and state laws and regulations, and contract provisions.

STEWARDSHIP AND OVERSIGHT OF FEDERAL FUNDS

Providing oversight of Federal funds received by local entities.

The Stewardship and Oversight Agreement between the Federal Highway Administration and Caltrans establishes roles and responsibilities for oversight activities and requires Caltrans to assess subrecipient accounting controls of local entities through various monitoring activities described in Caltrans' Local Assistance Procedures Manual (LAPM), including: Indirect Cost Allocation Plan (ICAP) acceptance and audit process, Incurred Cost Audits, Pre-award Agency Audits, and Single Audits. The 2018-19 Audit Plan includes the actions described below to comply with these requirements.

Submission reviews and audits of local governments Indirect Cost Rate Proposals and Indirect Cost Allocation Plans (ICRP/ICAP).

ICRP/ICAP submitted by local governments are reviewed for compliance with the requirements of 2 CFR Part 200 (formerly 2 CFR 225). Once determined that the ICRP/ICAP meets the submission requirements, the IOAI issues acceptance letters to allow local governments to bill Caltrans for indirect costs. A risk assessment is performed to identify ICRP/ICAPs that will be subject to additional review or audit. The IOAI contracts with the Department of Finance to perform a portion of these audits.

The objective of the audits is to determine whether the ICRP/ICAP rate is in compliance with 2 CFR Part 200 (formerly 2 CFR 225) and whether local governments are in compliance with required procedures and have a financial management system capable of accumulating and segregating costs that are reasonable, allowable, and can be allocated to projects or specific cost objectives.

Audits of incurred costs.

Audits of Incurred Cost of local governments determine if project costs claimed and reimbursed are supported and in compliance with agreement provisions, and state and federal laws and regulations; and if the local entities have a financial management system capable of accumulating and segregating costs that are reasonable, allowable, and can be allocated to projects or specific cost objectives. The Audit Plan also includes audits of local entities' recent procurements and contract management to determine if the training and outreach provided by Division of Local Assistance has improved adherence to procurement requirements.

MANDATED AUDITS AND ASSIGNMENTS

Mandated audits are required by statute, policy, standards, or agreement. The 2018-19 Audit Plan includes the following mandated audits and assignments.

Proposition 1B Bond Audits.

The California Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006 (Proposition 1B) dedicated \$19.925 billion over a ten-year period for transportation projects. Under Government Codes 8879.2(c) and 8879.50, audits are required of bond project expenditures and outcomes. The IOAI is responsible for mandated performance audits to determine if Proposition 1B bond fund recipients complied with federal and state procurement requirements, project costs reimbursed were allowable, and to ensure project deliverables were provided and outcomes were achieved. The IOAI contracts with the Department of Finance to perform a portion of these audits.

Cal-Card–(Biennial).

Cal-Card is an alternative payment method developed by DGS for use in the procurement of authorized goods and services. The State Controller's Office (SCO) has responsibility to ensure the payments associated with the use of the Cal-Card are appropriate and in compliance with state requirements. In 1998, the SCO entered into a memorandum of understanding (MOU) with Caltrans that delegated the responsibility for the review and retention of Cal-Card purchasing documentation to Caltrans. As part of this MOU, IOAI is required to biennially review internal controls and transactions paid through Cal-Card in accordance with guidelines prescribed by SCO. For fiscal year 2018-19, the IOAI is only required to provide a status report of prior audit findings to SCO.

Quality Control Review.

The International Standards for the Professional Practice of Internal Auditing AS 1311 requires “Ongoing monitoring of the performance of the internal audit activity; and periodic reviews performed through self-assessment or by other persons within the organization with sufficient knowledge of internal audit practices.”

The General Standard of the Generally Accepted Governmental Auditing Standards (GAGAS) 3.93 requires an “audit organization should establish policies and procedures for monitoring of quality in the audit organization. Monitoring of quality is an ongoing, periodic assessment of work completed on audits designed to provide management of the audit organization with reasonable assurance that the policies and procedures related to the system of quality control are suitably designed and operating effectively in practices.” GAGAS 3.95 requires “the audit organization should analyze and summarize the results of its monitoring process at least annually.”

To comply with professional auditing standards, an annual internal quality control review of IOAI’s External Audit offices will be performed in 2018-19 and every two years thereafter.

Enterprise Risk Assessment.

Based on the results of the Enterprise Risk Management audit discussed in the Accountability under SB 1 section above, the IOAI may need to initiate an additional review of enterprise risk to inform development of the 2019-20 Audit Plan.

Reimbursement Claims.

State Administrative Manual (SAM) Sections 8776.6 and 8776.7 provide specific requirements Caltrans must follow if all reasonable collection procedures do not result in payment and a request for discharge from accountability of uncollectable amounts due from private entities is filed. According to SAM Section 8072, if an internal audit unit exists within a department, the claim must be reviewed and signed by the head of the audit unit attesting to whether the department has complied with applicable SAM requirements. These claims will be reviewed by the IOAI.

INVESTIGATIONS AND ETHICS HELPLINE

Conducting investigations.

The Investigations Unit of the IOAI conducts independent, confidential administrative investigations involving allegations of employee misconduct. Investigations can result from: complaints from Caltrans management and/or employees, Caltrans' Ethics Helpline, audit findings, and/or direct contact from a member of the public. Investigative staff works collaboratively with Caltrans management at all levels (districts, programs, and divisions) to investigate and report on allegations of employee misconduct. The Investigations Unit also assists external entities, including the California State Auditor and law enforcement agencies with investigations involving Caltrans employees. Consistent with the requirements of SB 1, the Inspector General reports all audit and confidential investigation findings and recommendations to the Secretary of Transportation and the Caltrans director and chief deputy on an ongoing and current basis.

Managing the Caltrans Ethics Helpline.

Caltrans launched a phone and internet-based, multi-lingual site available at all times for Caltrans employees to report allegations of possible fraud, waste, and abuse, employee misconduct, and other wrongdoing. Management of the Ethics Helpline transferred to the IOAI in January 2018. Examples of complaints received include allegations of abuse of state resources (i.e. time, vehicle, and equipment), falsification of documents, discrimination, hostile work environment, and conflict of interest. The Investigations Unit of the IOAI conducts a preliminary review of the complaints to determine the appropriate course of action, which may include, follow-up from management within Caltrans, formal investigation by the IOAI, and/or referral to law enforcement.